

OF BAILED-OUT BANKS IN NIGERIA

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ABSTRACT

This paper extends an earlier proposed framework and thus empirically examining the effect of board equity ownership on the performance of banks in an era of post banking crisis that called for a bailout reform in Nigeria. This board attribute is selected based on the peculiar problem of the banking sector, and based on the board functions that captures monitoring (agency theory based). Based on a survey data, the result of our analysis revealed a significant relationship between board of directors' equity ownership and banks performance. We therefore, suggest more regulation and enforcement of this as it motivates and compels boards to be more vigorous at monitoring CEOs/top managements.

Keywords: Corporate governance; board equity ownership; banks performance

1. INTRODUCTION

Banking as a financial sub-sector is one of the most regulated sector due to its immense support to the overall economic growth and development of any nation. The intensive and sensitive financial operations makes it inevitable to fully secure the transactional processes in order to stabilize the system from economic shocks, failure, and also protect depositors, investors etc. In the Nigerian financial sector, poor managerial performance and poor corporate governance (CG) had been identified as the major factors in virtually all known cases of a financial institution's distress in the country which even led to consolidation reform in 2004,

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and yet re-emerged afterwards, and led to another reform in late 2009 that necessitated the bail-out of ten (10) banks which nearly collapsed due to high non-performing loans, poor CG, bad liquidity and risk management (CBN, 2010). The bail-out reform became the only rescue program which could ensure the continuous survival of the banking industry by injecting N620 billion. This bail-out reform generated a lot of panic and doubt concerning the status of the investments of these banks' depositors, shareholders and other Nigerians consequently, led to a sparked interest in examining the potential outcome of this reform through researches.

However, this paper aims at testing empirically, a part of an earlier proposed framework. Thus, this paper has examine the potential relevance of board equity ownership (BEO) in enhancing the performance of these bail-out banks. This study is hence is proposing a framework that selects the most appropriate board variables that best address the banks' CG problems peculiar to Nigeria. This framework, unique as it is, aims at covering only the bailed-out banks with a total of 2,811 branches in Nigeria using a primary source of data (questionnaire). There is paucity of studies in Nigerian context that conceptualised BEO as a performance booster and then evaluating based on financial and non-financial performance.

The mid 2000s actually witnessed a renewed academic interest in the area of CG and firm performance mainly due to the prevalence of global financial crisis. However, most researches conducted globally and Nigeria in particular, are reported with conflicting findings as a result of factors like; inconsistent operationalization of board variables, limited scope, and convenience samples (Hillman & Dalziel, 2003; Zahra & Pearce, 1989). Studies in the Nigerian context which adopts this variable that captures board control or monitoring role are very rare, hence the need to be re-examined to inconclusive relations/findings. Also, most of the studies on CG in Nigerian context are either conducted before the banks' bail-out, or not in the area of bail-out reform or not covering the banking sector such as Adekoya, (2011); Okereke, Abu, & Anyanwu, (2011); Onakoya, Ofoegbu, & Fasanya, (2012); Uwuigbe & Fakile, (2012). Only few studies were found on bail-out such as "Kuye, Ogundele, & Otiike-Obaro, (2013); Nworji, (2011); Oghojafor, Olayemi, Okonjia, & Okolie, (2010)", which all have certain kind of shortcomings, small sample, addressing policy issue not the banks' performance etc.

Specifically studies on CG covering both financial and non-financial performance are very rare in Nigeria except Ogbechie et al., (2009). The result of our analysis revealed that BEO had a significant positive relationship with performance. This paper recommends that BODs equity ownership must be enforced in order to improve corporate governance practices in firms. This outcome is of immense importance to academics, regulators, shareholders, and other Nigerians as it will reveal the contribution of BEO in strengthening board of directors' functions in ensuring good banks' performance. The paper is subdivided into six (6) sections from introduction, literature review, methodology, discussion and conclusion, limitation, then reference.

2. LITERATURE REVIEW

2.1. Corporate governance and board monitoring function (agency theory based)

Also, this study adopts agency theory in the framework as in de Villiers, Naiker, & van Staden, (2011); Hillman & Dalziel, (2003) which opined that boards have the functions of monitoring management's activities. Agency theorist asserts that management initiates and implements business plans, strategies, and systems whereas directors monitor it (de Villiers et al., 2011; Zahra & Pearce, 1989). Under this view, independent directors and directors who own shares will be more likely to monitor rigorously (Bhagat & Bolton, 2008; de Villiers et al., 2011; Hillman & Dalziel, 2003). This study therefore, propose this board variable in this paper which reflect directors' monitoring role (driven by agency theory). Additionally, these variable is actually selected based on its prominent importance in solving the practical problem of corporate governance in Nigerian banks as mentioned in (Sanusi, 2010)

According to the agency theorists, firms are often characterized by a conflict of interest between firms' management and shareholders, where managers usually exploit their control over firm operations to increase their short-term wealth at the expense of shareholders' long-term interests as opined by Fama and Jensen (1983), Jensen and Meckling (1976). However, the presence of vigilant directors can reduce such agency costs by close monitoring of firm management activities, control system (Hermalin & Weisbach, 1991; Hillman & Dalziel, 2003; Westphal, 1999). Directors who intensely monitor management, are more likely

to demand explanations for management's strategic initiatives and to criticize misguided initiatives (de Villiers et al., 2011; McNulty & Pettigrew, 1999). However, to the best of our knowledge, no study has been conducted using these selected variable together in a single framework on the Nigerian bail-out banks.

2.2. Board equity ownership

Practically, the implementation of CBN code of corporate governance in Nigeria, posed some challenges, prominent among which were: ambiguities regarding the appointment of independent directors and the share ownership status of these independent directors (CBN, 2008). Thus, it has been an unresolved debate concerning the potential importance/ effect of board members' equity ownership on both the board functional performance and firm performance. Albring et al. (2013), opined that in the USA, the Blue Ribbon Committee (1999), among others, suggests that director stock ownership should reduce agency problems and therefore the need for external monitoring. Thus, in an attempt to make a proper alignment of the interest of director and shareholders, many boards have implemented stock ownership guidelines and holding requirements for directors, leading to a substantial rise in the ownership of managers and directors but in Nigeria, there exist ambiguities and challenges regarding the directors share ownership status (CBN, 2008). There exist conflicting researchers views regarding this which upto now, no clear position is given by the CBN. This show the real extent of the misconception on whether or not equity ownership by the board of Directors would influence their mandated functions. Also, the percentage of the shareholding is still not clearly determined. However, Bhagat & Bolton, (2008); de Villiers et al., (2011); Hillman & Dalziel, (2003) opined that Stock ownership aligns the interests of the directors with those of shareholders. Bhagat & Bolton, (2008)'s study further revealed that particularly in poor firm performance, the likelihood of disciplinary management turnover (replacement) is positively correlated with stock ownership of board members. As such, directors with more equity ownership are likely to objectively evaluate firm performance and control firm choices. Similarly, Weisbach (1988) also reported that CEO replacement in poorly performing firms was greater as the representation of independent outside directors increases. Board members (both executive and non-executive) share ownership reduces manager/shareholder conflicts to the extent that executive board members own part of the firm, they develop shareholder-like interests

and are less likely to engage in behaviour that is detrimental to firms' / shareholders interest.

On the contrary view, Demsetz and Lehn (1985) reported no correlation between board's ownership and firm performance, and opined that there trivial support for the divergence of interests between managers and shareholders. Fama and Jensen (1983) argued that contribution of board's ownership is considered as a "two-edged knife" in which there is an optimal level of board ownership which contributes positively to a firm's performance. However, the study of Morck, Shleifer, and Vishny (1988) revealed that firm performance first improves as ownership rises up to 5%, then falls as ownership increases up to 25% and then rises slightly at higher ownership. McConnell and Servaes (1990) provide further evidence on the relation between the distribution of equity ownership and firm value and find a significant curvilinear relation between them. By and large, board ownership, was viewed as an encouragement that will help board members supervise management in a more efficient way. Consistent with the positive view, (Chung & Pruitt, 1996; Jensen & Murphy, 1990; Mehran, 1995) supported that, board's ownership will improve firm's performance and are positively correlated. More related to this study, (Bhagat & Bolton, 2008; de Villiers et al., 2011; Hillman & Dalziel, 2003; Westphal, 1999), show that director ownership influence or improves boards' monitoring of strategic decision making. (Hillman & Dalziel, 2003) argue that ownership incentives motivate directors to forgo short- term returns for long-term projects and strategies.

The study further argues consistent with many studies like Albring et al., (2013), Bhagat and Bolton, (2008); de Villiers et al., (2011); Guest, (2008) that, if these banks' board of directors were having a substantial equity ownership in the banks or compensated with equity as incentives for a targeted performance, they would definitely have monitored and counselled those sacked incompetent/fraudulent banks' managements. In the current aftermath of banking crisis, it is plausible that higher ownership could motivate directors to monitor and provide resources (advices, counsel connections etc.) to management which will in-turn lead to higher firm performance in the long run. Thus, we form the following proposition:

H.1 Equity share ownership of board of directors is positively related with the bail-out banks' performance.

3. METHODOLOGY

This paper adopted a survey research method, and collected data by use of a questionnaires which were administered to branch, middle & top managers of bailed-out banks. This paper had a population of 2,811 branches from the ten (10) bailed-out banks in Nigeria. The sample size is 338 determined through sample size formula/table of Dillman (2000), Krejcie and Morgan (1970). Although a 50% was added to the sample size making it to be 507 in order to cater for low or non-response bias (Salkind, 1997). Using a stratified sampling technique, the number of branches for each bank were drawn proportionately to the total number of branches in their respective strata (banks). The collected data was screened at the preliminary stage and few missing data treated, outliers deleted and then normality and multicollinearity tests conducted revealing a good data that is normally distributed. This study adopts the Balance scorecard (BSC) performance model which was developed by Kaplan and Norton (1996). The measures consist both financial and non-financial measures which serves as indicators used in monitoring strategy implementation throughout the organization and whether strategic goals are being achieved or not (Bremser & Chung, 2005).

This paper adopts Partial Least Square (Smart-PLS) to run this multivariate test in order to analyse or test the hypothesized relationships in the study. PLS approach is commonly used in most recent researches due to its capability of analysing the relationship between the latent constructs and their measures, modelled in a reflective or formative ways as well as hybrid formative and reflective constructs (Hair et al., 2014). Smart-PLS 2.0 (Ringle et al., 2005) is used for assessing the path model and estimated the parameters based on path weighting scheme (Henseler, Ringle, & Sarstedt, 2012). In this paper, we firstly assessed the measurement model and then followed by the structural model from which our results is presented sequentially. In this study, the model is a reflective measurement model and therefore the quality criteria used comprises the composite reliability (CR) which examines the internal consistency, average variance extracted (AVE) which examines the convergence validity and then Fornell-Larcker criterion, & Loadings-cross loadings which examines discriminant validity.

3.1. Measurement model

The result of the measurement model basically interprets the goodness of the measures through the reliability and validity as shown in the subsequent tables. Apparently, there are three quality evaluation criteria namely; (1) the significance level of factor loadings of all items, then (2) the Composite Reliability (CR) of the items should be at least 0.7 and above, and (3) the Average Variance Extracted (AVE) should be at least 0.5 and above (Henseler et al., 2012). The Goodness of measures are determined through the measurement model by revealing the relationships between the items that measures each construct and other constructs in the model. The Reliability test evaluates how consistently measuring instruments measures the what it is meant to measure, while validity tests evaluates how well an instrument measures an exact concept it is designed to measure (Hair et al., 2014).

In this study, the measurement model was examined through the outer model by evaluating the relationship that exist between constructs and their indicators (Hair, Hult, Ringle, & Sarstedt, 2014). As displayed in Table 1 below, the convergent validity was achieved because the internal consistency reliability represented by composite reliability is actually within the range of .75 to .92 hence, exceeding the required minimum of .70. As for the average variance extracted (AVE), the minimum requirement of .50 is also exceeded for all the constructs in the model (Hair et al., 2012). Performance was subjected to second order based on (FP and NP) and also have achieved all. The discriminant validity is assessed in two ways. Firstly, using Fornell-Larcker (1998) criterion in Table 2, the square roots of AVEs were exhibited diagonally while the off the diagonal figures signifies the squared inter-construct correlations and it could be seen that all the AVEs exceeds the squared inter-construct correlations, signifying the achievement of the requirement for discriminant validity. Discriminant validity was further confirmed through ensuring that all indicators' loadings were actually more than their respective cross loadings in the model. After these were examined, we thus testifies that the reliability and validity of our constructs was satisfactorily achieved (Hair et al., 2014).

Convergence Validity and Reliability Analysis (Item loadings, Average variance extracted and Internal consistencies)

Table 1: Results of the Measurement Model

Constructs		Items	Loadings	AVE	Composite Reliability
Board Ownership	Equity	BEO3	.551	.509	.752
		BEO4	.773		
		BEO5	.790		
Financial Performance		FP10	.780	.522	.867
		FP5	.778		
		FP6	.728		
		FP7	.697		
		FP8	.623		
		FP9	.718		
Non-financial Performance		NP11	.730	.508	.892
		NP12	.713		
		NP13	.649		
		NP14	.713		
		NP15	.708		
		NP16	.743		
		NP17	.784		
		NP18	.651		
Performance		FP	.904		.855
		NP	.946		

Table 2: Discriminant Validity (Square root of AVE and Latent Variable Correlations)

Constructs	BEO	FP	NP
Board Equity Ownership (BEO)	.713		
Financial Performance (FP)	.291	.723	
Non-financial Performance (NP)	.331	.716	.713

Note: The bolded diagonal figures are the square root of the variance (AVE) shared between the constructs and their measures while the off-diagonal figures were the correlations among constructs.

Basically before the structural model, multicollinearity was further assessed and as known, there is no need for that because only one variable is involved in the analysis hence, this confirms that no multicollinearity exists among constructs of this study. Normally the VIFs values should be less than the 5.00 threshold (Hair et al., 2014).

After this, then the structural model is evaluated to test the significance of the paths and thus reveal the supportive or otherwise of the developed hypotheses. The next figure 3 is the structural model showing the t-value of the path.

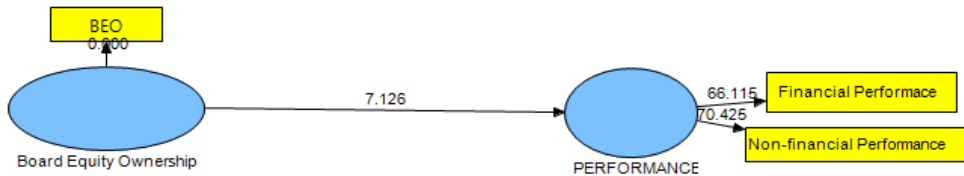


Figure 1: Structural Model

In examining the structural model's relationships the path coefficients significance, and R^2 value were measured (Hair et al., 2014). This paper used the mart-PLS standard bootstrapping method with 5000 bootstrap samples to evaluate the significance of the path coefficients (Hair et al., 2014; Hair, Sarstedt, Pieper, & Ringle, 2012; Henseler, Ringle, & Sinkovics, 2009). The results of the hypotheses testing, their coefficients, t values and the p values were all presented in Table 5. From the above figure 2, and table 5, it can be seen that all the hypothesized relationship were supported.

Table 4: Result of Hypotheses Test

Hypotheses	Relationship	Beta	Standard Error	T Value	P Value	Decision
H1	BEO -> PERFM	.331	.046	7.126	.000	Supported

4. DISCUSSION AND CONCLUSION

This study have tested the existing agency theory presumption in respect to the possible effect of board equity shareholding by taking managers' perception regarding its influence on performance. This study had magnificently conceptualised performance as a second order hierarchical construct, signifying that all two dimensions (financial and non-financial) expressively reflect performance. The theory's assumption is found to be supported by our result.

From the result from table 4 above, it is found that Equity ownership of BODs (BEO) has a significant effect on banks performance revealing ($\beta=.331$, $t=7.126$) confirming a strong relationship exist between them. The strength of the path is so extremely good that the hypothesis is accepted at even 1% level of significance. Hence, this hypothesis is supported.

The implication of this is that equity shares ownership by board of directors of a bank definitely influences them to effectively monitors, advice, counsels, and guide their executive managements during strategic decision making. Our results is consistent with the previous studies like Albring et al., (2013), Bhagat and Bolton (2008), Bhagat et al., (1999) who contend that board equity ownership motivates directors to vigorously evaluates CEO/management's performance, firm performance, be involve in strategic decision making and also deliberate on issues before approving them. The rationale is that their share ownership aligns their interest with that of other shareholders, therefore, they will be effective at monitoring, and resource provision because they want to protect their investments (de Villiers et al., 2011; Fama & Jensen, 1983; Hillman & Dalziel, 2003).

This study contributes immensely to the growing literature by confirming that BEO influences, motivates directors by improving their functional effectiveness in providing advisory, guidance, and other resources to the

managements' overall strategic control system. Secondly, the findings of this research will provide significant contribution to the managers and banks regulators like CBN, NDIC etc. This results thus, implies that with a substantial BEO, banks stand a chance of having a better performance after the bail-out reform.

Thirdly, equity ownership by board of directors must be specifically regulated and enforced by CBN because the a CBN annual supervision report of 2008 stated that "there exist an ambiguity regarding equity ownership of directors" (CBN, 2008) and therefore, it is not surprising that lack of substantial equity ownership in their banks made the BODs refused to dismiss and replace the poor performing CEOs in their respective banks. However, the likelihood of replacing CEO/top management for disciplinary reasons when circumstances warrants is part of the monitoring process which is only motivated and ensured if the directors are having a substantial equity shares ownership in the company (Albring et al., 2013; Bhagat & Bolton, 2008; Bhagat et al., 1999; Zahra, 1996).

5. LIMITATIONS AND SUGGESTION FOR FUTURE STUDIES

Our study is limited to examining only the overall performance (comprising both financial and non-financial) as a single second-order reflective construct. Therefore, the result is only indicating the effect of BEO on overall performance without knowing the relative effect on each of the two dimensions. Also, our sample is restricted to only the bailed-out banks in Nigeria.

Future research should therefore examine the effect of BEO on both financial and non-financial performance together as two different endogenous variables so as to determine their response to BEO. In respect sample size, future studies should look into the whole banks in the industry.

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